

TAXATION ISSUES IN CHAPTER 13

HOW TO AVOID PITFALLS AND GET DEBTORS COMPLIANT

1. INITIAL CONSULTATION/FILING OF PETITION AND SCHEDULES

Section 1325(a)(9) requires that the Debtor has filed all applicable Federal, State and local tax returns as required by section 1308 for a Chapter 13 plan to be confirmed by the Court. Section 1308 requires all tax returns for all taxable periods ending during the 4-year period ending on the date of the filing of the petition be filed prior to the 341 hearing, but with some exceptions. To verify all tax returns are filed, the United States Bankruptcy Court Western District of Virginia enacted Local Rule 3015-3 (codifying Standing Order #10), for the Debtor to certify under oath he or she has filed all required tax returns. The purpose of the pre-confirmation affidavit is to provide evidence of compliance with § 1325(a)(9). Counsel should use new tools available by IRS to ensure that the Debtor is compliant before having the Debtor sign the preconfirmation affidavit.

Section 1308 specifically requires that all required tax returns for the 4-year period ending on the date of filing the petition be filed before the date of the first scheduled meeting of creditors. The Trustee can use discretion subject to § 1308(b)(1) and can also move for dismissal in the event the returns are not timely filed. Section 1308(b)(1) and (2) provide for the 341 meeting to be held open and for an extension of the time to file returns if necessary. But, counsel should be careful in using these provisions. A case cannot be confirmed unless and until the returns are filed (and often processed) and an unnecessary and unreasonable delay can result in dismissal.

Tax returns can provide a wealth of information as to the Debtor's circumstances. Counsel should be reviewing previous returns to ensure the petition and schedules are consistent with the information on the return. Does the income on the return match the Statement of Financial Affairs? Did the Debtor's tax return reveal income not contained in the bankruptcy worksheets/paperwork such as 1099 income, royalties, distributions from a retirement account or interest/dividends? If a head of household return is produced by Debtor(s), it is best practice to review the return and follow-up with the Debtor(s) to ensure they are not claiming a filing status for which they are not entitled.

Debtor's Counsel Practice Tips:

- *Ask your client at the initial meeting if he or she has filed all required tax returns.*
- *While section 1308 refers to the last four years, if the Chapter 13 Trustee discovers there are unfiled returns for prior years, he or she is unlikely to recommend the case for confirmation.*
- *Make sure you as counsel understand this means all personal state and federal returns and any business returns required if your Debtor was self-employed or running a business.*

- *If your client has not filed all required returns, assist him or her in doing so, make sure to have proof of filing (certified mail or proof of electronic transmission) and copies of the returns.*
- *Make sure your client understands he or she is signing the pre-confirmation affidavit under oath.*
- *If you discover the pre-confirmation affidavit is inaccurate, immediately withdraw it and be prepared to explain the issue to the Court if asked.*
- *Recognize that the IRS may report a return as unfiled, when in reality it just has not been processed. This is why it is important to track delivery of any recently filed returns.*
- *Remember to ask the Debtor about personal property taxes and real estate taxes and provide for those in the schedules if owed.*

2. TOOLS TO ASSIST COUNSEL/DEBTOR

IRS has relatively new changes that allow counsel to check the status of their client's previous returns online.

1. Debtor's counsel will need to complete and sign a Form 2848.

a. CAF number: Upon the first time filing for third party authorization, counsel will be assigned a CAF number. This is a 9-digit identification number and is assigned the first time a third-party authorization is filed with the IRS. A letter will be sent to counsel assigning the number and this specific number should be used in all future third-party requests.

2. Online resources:

Form 2848 Instructions: <https://www.irs.gov/instructions/i2848>

CAF Information for Form 2848:

<https://www.irs.gov/businesses/small-businesses-self-employed/the-centralized-authorization-file-caf-authorization-rules>

3. IRS Secure Messaging Feature of Taxpayer Digital Communications (TDC). This allows practitioners to submit authorizations on Form 2848 and Form 8821 (tax information authorization) electronically and allows for acceptance of electronic signatures. **Note:** IRS still cannot accept electronic signatures via fax or email on Forms 2848 and 8821. The only method electronic signatures are accepted are through the TDC platform.

a. Electronic signatures can appear in several forms:

1. A typed name that is typed into the signature block(s).
2. A scanned or digitized image of a handwritten signature that is attached to an electronic record.

3. A handwritten signature input into an electronic signature pad.
4. A handwritten signature, mark, or command input on a display screen with a stylus device.

4. Helpful IRS self-help online links

E-Services - Online Tools for Tax Professionals

<https://www.irs.gov/e-services>

Tax Professionals IRS.gov webpage

<https://www.irs.gov/tax-professionals>

Debtors Online Self Help Tools (Register for online account)

<https://www.irs.gov/individuals/secure-access-how-to-register-for-certain-online-self-help-tools>

Debtors Online Tax Account Tools

<https://www.irs.gov/payments/view-your-tax-account>

Debtors Online Transcript Request Tools

<https://www.irs.gov/individuals/get-transcript>

Debtor's Counsel Practice Tips:

- *Some bankruptcy software providers have related programs which can retrieve tax account or tax return transcripts for a reasonable fee.*
- *Debtors can usually use the get-transcript website to easily retrieve federal tax account or tax return transcripts.*
- *Tax account transcripts are critical to assisting counsel in determining dischargeability and the presence of any liens if there is tax liability.*

5. Commonwealth of Virginia: State tax information can be confirmed by e-mailing Tax Authority Consulting Service (TACS), the entity which handles the bankruptcy collections for the Commonwealth of Virginia.

Debtor's Counsel Practice Tips:

- *After filing the case, counsel can contact the bankruptcy department of TACS (bankruptcy@taxva.com) and simply inquire if the Debtors have any outstanding returns.*
- *For Virginia, counsel can simply scan any missing returns, email to TACS and TACS will forward the return for filing to the Department of Education.*

III. ESTIMATED TAXES: HOW TO QUICKLY GET DEBTOR(S) COMPLIANT

If a Debtor has not filed taxes for a taxable year, the IRS/State of Virginia will file a proof of claim for *estimated* taxes. Claims for estimated taxes must be resolved in order for a plan to be recommended for confirmation. Estimated tax claims often delay confirmation, but there are ways counsel can expedite the process so the IRS/State of Virginia can promptly file an amended proof of claim.

Debtor's Counsel Practice Tips:

- *Upon the filing of a claim by the IRS or Virginia showing estimated taxes due to unfiled returns, counsel must take timely action to investigate and remedy the situation.*
- *First, verify with the Debtor how and when the "missing" returns were filed. Determine if there is proof the return was filed, or if there is simply a delay in the processing of the return. Collect information from the Debtor and contact the representative that filed the return to assist with this analysis.*
- *If there is no proof the return was filed, counsel suggests the return be "re-filed" with all appropriate supporting information and new signatures. Returns should be mailed certified mail so that delivery can be tracked. Then, send the return and proof of filing to the tax representative whom filed the claim and ask the claim be updated "per return." This normally works for income taxes, absent unique situations.*
- *Sometimes, you will get an estimated tax claim for a new assessment based on previously undisclosed information or a business pass-through assessment. In these cases, your client may have to sign an official form agreeing to the assessment before the claim can be updated. The tax representatives can be very helpful in identifying when this is needed.*

IV. § 1305 CLAIMS

Section 1305 claims are post-petition tax claims. These post-petition claims can be filed by any entity that holds a claim against the Debtor for taxes that become payable to a governmental unit while the case is pending. If a 1305 claim is filed, it is important for counsel to review the claim as quickly as possible. Common 1305 claims are claims for self-employed individuals or those under-withholding whose income taxes are incurred post-petition.

It is in the discretion of the taxing authority to file a Section 1305 claim. Virginia rarely files post-petition claims and the Internal Revenue Service's position seems to change periodically. It is questionable if the Debtor can file a 1305 claim for the taxing authority as the statute provides the "entity that holds a claim" can file such a claim.

Debtor's Counsel Practice Tips:

- *In the past, the IRS would actually file a Motion to Dismiss the case if the Debtor continuance incurred §1305 claims.*
- *If your Debtor has §1305 claims, review his or her withholding or the reason for the liability and determine if withholding changes or other financial counseling can help avoid a future occurrence.*

V: SECTION 523(a) AND DISCHARGE OF TAX DEBTS

To avoid potential malpractice claims, counsel should carefully review tax claims to properly advise regarding dischargeability. Analyzing whether a tax debt is dischargeable can be a complicated analysis.

§ 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1192, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –

(1) for a tax or a customs duty –

(A) of the kind and for the periods specified in section 507(a)(3) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed;

(B) with respect to which a return, or equivalent report or notice, if required;

(i) was not filed or given; or

(ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; or

(C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

Statutory interplay:

11 U.S.C. 507(a)(8) outlines priority tax claims and 523(a) addresses what is dischargeable:

1. Sec. 507(a)(8): Income taxes for taxable years ending before the filing of the petition for a return due (includes extensions) after 3 years of the date of filing the petition.
 - a. Example: Debtor files bankruptcy on May 1, 2021. Debtor owes for taxable years 2017-2020. The returns are due on April 15, 2021 for tax year 2020. This means all three years are priority because the clock starts at the date due (presumptive date) for that taxable year.
2. Sec 523(a) as exception to discharge:
 - a. If no return is filed, the debt is not subject to discharge.
 - b. If the return was filed more than two years
3. Reading 507(a)(8) and 523(a) together creates the following analysis:
 - a. Timely filed, but no payment, then amounts due are dischargeable under 523(a)(1)(A) if:

- i. the tax returns to report such unpaid income or gross receipts were due more than three (3) years before the petition date and,
 - ii. they were filed timely.
- b. Late filed returns are dischargeable under Section 523(a)(1)(B)(ii) if:
 - i. Returns actually filed more than two years before the petition date (Calculated by actual filing date, not presumptive date.)

Debtor's Counsel Practice Tips:

- *Reviewing tax account transcripts is critical in the analysis of dischargeability.*
- *Be aware that the deadlines to determine dischargeability only apply to returns the Debtor actually filed. If the IRS filed a return for the Debtor, the return remains "forever" unfiled as to the dischargeability, even if the Debtor files the return subsequently to adjust the amount owed.*
- *Be aware that if Virginia assesses additional liability upon un-reported or under-reported income and no amended tax return is filed, Virginia takes the position the "return" is unfiled and the liability is not dischargeable.*

VI. HEAD OF HOUSEHOLD RETURNS

HOH filing status can generate a larger refund due to a lower tax rate and higher standard deduction. The HOH filing status is sometimes improperly claimed. Counsel should be careful to review any HOH returns to ensure the Debtor is entitled to that status. If the Debtor is filing jointly or has the spouse in the household, it is best practice to inquire as the circumstances of the living arrangements for that taxable year.

In order to qualify for HOH status, the IRS will look for three things:

1. Marital status requirement: Taxpayer must be (1) divorced or legally separated, (2) had not lived with the spouse in the last six months of the year and (3) taxpayer and spouse must file separate returns.
2. Support requirement: Taxpayer must have paid more than half the costs of keeping up the home during the year (rent, utilities, etc.)
3. Dependent requirement: Taxpayer must have qualifying dependent.